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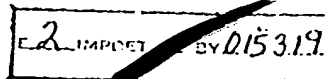
16 June 1976

MEMORANDUM FOR THE RECORD

SUBJECT: Transmittal of Briefing Paper

The attached briefing paper was delivered by courier on 16 June to Office of National Security, Department of Treasury for his office's use in preparing for Secretary Simon's trip to Eastern Europe.

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Soviet Price Increases and Their Impact on Poland, Romania and Yugoslavia

Background

The Soviet Union raised prices in 1975 and again in 1976 to its CEMA trading partners. Poland and Romania, with their fuel and raw material trade with the USSR in relative balance, were less affected by Soviet price increases than other CEMA countries. (Yugoslavia is not a full member of CEMA and trades with the USSR at world prices). Moscow's decision to raise prices was based in large part on its unwillingness to continue to supply oil and raw materials to Eastern Europe at fixed prices -- the East Europeans paid only \$3.00 a barrel for Soviet oil in 1974 -- at a time when world prices had risen spectacularly. Moreover, Moscow had long been unhappy over its deliveries of fuel and raw materials to Eastern Europe in return for overvalued machinery, which is often priced at the level of superior Western models.

The largest price increases in 1975 were for fuels, power and basic materials -- items on which Eastern Europe is heavily dependent on the USSR. Prices of crude oil, natural gas and coal more than doubled and the price of electricity increased by half. The Soviets also raised prices of pig iron by 57%, iron ore 25%, asbestos 28%, and cellulose 26 to 60%. Moscow agreed to increases, although smaller ones, for machinery and various manufactured goods, which make up the bulk of the USSR's purchases from Eastern Europe. For example, prices for Polish consumer goods sold to the USSR were increased by 25%. In 1976, the Soviets raised the price of crude oil an additional 8% and imposed price hikes -- smaller than last year -- on natural gas, wood, paper, cellulose, and some chemicals.

Despite price hikes in 1975 and 1976, prices in CEMA trade of many raw materials are still well below world levels. For example, the East Europeans are now paying only \$7.25 a barrel for Soviet crude oil -- about a third below the world price. In an attempt to offset its disadvantage, Moscow has pressured the East Europeans to a) buy more Soviet machinery, b) buy more oil in the West, c) invest in Soviet raw material projects and d) accept a new CEMA pricing formula with annual price changes based on a moving five year average of world prices. Despite adjustments stemming from these demands, the USSR is still at a disadvantage in trade with Eastern Europe.

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Poland

Poland, with its abundant raw material resources, has not suffered much from higher Soviet prices for oil and other raw materials. Although the country relies on the USSR for nearly all of its crude oil, pig iron, and natural gas imports and for more than half of its cotton imports, Poland also exports sizeable amounts of coal and coke and some zinc and copper to the Soviet Union. Since these Polish exports also benefitted substantially from price increases, Poland's terms of trade with the USSR declined only an estimated 6% to 8% in 1975. If, as the Poles claim, this decline is offset by improved terms of trade with other CEMA countries, Poland may be able to divert some exports from Eastern Europe rather than from the West to cover the gap resulting from declining terms of trade with the Soviets. In any case, it is expected that the higher Soviet prices will not have much impact on the degree of Polish dependence on the USSR.

To obtain additional deliveries of Soviet fuel and raw materials, the Poles have acceded to Moscow's demands for investment in projects in the USSR. Poland has already become involved in several cooperation projects in the USSR, including the Orenburg natural gas pipeline and the Kursk metallurgical combine. In return, Poland will receive deliveries of natural gas and of enriched iron ore and ferroalloys. Poland has also agreed to help build an oil pipeline in the USSR in exchange for additional supplies of Soviet crude oil.

Romania

Romania has been less affected than any other East European country by Soviet price increases -- price hikes for imports from the USSR have probably been offset by price increases for Romanian sales to the Soviet Union. In contrast to the rest of Eastern Europe, Romania does not import any Soviet oil and indeed exported about 500,000 tons of oil products to the USSR last year. Because of the close balance on materials trade, Bucharest and Moscow agreed to limit price changes in 1975 to fewer than 100 commodities including iron ore, coke, petrochemicals, consumer goods and some agricultural products. Prices of machinery, which is a relatively small item in trade between the two countries and is also close to balancing, were also unchanged.

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Romania has been affected by Soviet unwillingness to boost fuel and raw material deliveries to Eastern Europe without investment in Soviet projects. Moscow has repeatedly rejected Romanian requests to begin purchases of crude oil from the USSR. Bucharest also is concerned about the dependability of Soviet deliveries of iron ore and the Romanians have been shopping in Brazil, India and Gabon for additional supplies. Romania has agreed to make deliveries on credit to the USSR in return for natural gas from the Orenburg pipeline project which is scheduled for 1978 completion. Romania's 1975 trade surplus with the USSR of \$160 million probably reflects these deliveries.

Yugoslavia

Yugoslavia has not been affected by Soviet price decisions within CEMA because Soviet-Yugoslav trade prices are determined largely by world market trends. Although Soviet-Yugoslav trade protocols indicate rough annual targets for trade volumes and values, commitments on pricing are made during the year in additional protocols and/or letters of credit and contracts in response to world market trends. As a result, in 1974, while prices of Soviet exports of oil, rolled steel, cotton fibers, and lumber remained steady for Eastern Europe, they rose considerably for Yugoslav as for Western customers.

Well-endowed with natural resources, Yugoslavia depends to a limited extent on Soviet supplies for basic energy and material needs. Last year, the USSR supplied about 25% of Yugoslav energy imports -- mostly crude and refined oil and some hard coal. During the next 5 years, imports of Soviet natural gas are scheduled to rise sharply -- as is development of Yugoslavia's extensive domestic hydro-electric potential. The USSR provides substantial supplies of ferrous metals, wood products and chemicals, but this is partly offset by net Yugoslav exports of nonferrous metals and agricultural produce.

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